

Residential Real Estate Lending

Consider the following procedures at each examination. Examiners are encouraged to exclude items deemed unnecessary. This procedural analysis does not represent every possible action to be taken during an examination. The references are not intended to be all-inclusive and additional guidance may exist. Many of these procedures will address more than one of the Standards and Associated Risks. For the examination process to be successful, examiners must maintain open communication with bank management and discuss relevant concerns as they arise.

POLICY CONSIDERATIONS

1 Determine the extent that the bank is engaged in secondary mortgage market activities (for example, mortgage servicing, warehousing operations, and loan origination for resale). If significant, consider completing the separate Mortgage Banking module.

2 Determine whether the institution is engaged in subprime lending in this area or plans to in the future. If subprime lending exists or is planned, consider the subprime lending examination procedures in conjunction with these guidelines. Refer to Subprime Lending Loan Reference module for additional information.

3 Determine if 1-4 family real estate mortgage lending policies, procedures, and practices are adequate and appropriate for the size and nature of the bank's real estate lending activities.

3 A Determine if the loan policy contains a general outline, or if there is a specific residential real estate loan policy, setting forth the way in which real estate mortgage loans are to be originated, serviced, and collected. The policy should satisfy the requirements of the Interagency Guidelines for Real Estate Lending Policies. In particular, the bank's policies on real estate lending should:

3 A1 1. Establish a loan portfolio diversification policy and set limits for real estate loans by type and geographic market.

3 A2 2. Establish prudent loan-to-value ratios and guidelines for when mortgage insurance or additional collateral is required. (For loans where the loan-to-value ratio exceeds 90% at origination, an institution should require appropriate credit enhancement in the form of either mortgage insurance or readily marketable collateral.)

a. Individual loans, of significant size, in excess of supervisory loan-to-value limits should be reported to the board of directors.

b. The aggregate of loans in excess of supervisory loan-to-value limits should be reported to the board of directors at least quarterly.

c. Aggregate loans in excess of supervisory loan-to-value limits should not exceed 100 percent of total capital. (FDIC: Appendix to the FDIC's Part 365, FRB: Subpart C of Regulation H.) (Note: Guidelines cited in the appendix are not part of the regulation.)

3 A3 3. Establish loan administration procedures. (Note: Loan administration procedures and documentation requirements may be separate from, but still referenced by, the loan policy.)

a. Application and financial statement requirements, including procedures to verify information provided by the borrower.

b. Frequency of financial information on income producing properties.

c. Loan closing and disbursement.

d. Payment processing.

e. Escrow administration.

f. Collateral administration.

g. Loan payoffs.

h. Collections and foreclosure, including:

- i. Delinquency follow-up procedures.
 - ii. Foreclosure timing.
 - iii. Extensions and other forms of forbearance.
 - iv. Acceptance of deeds in lieu of foreclosure.
 - i. Claims processing.
 - j. Servicing and participation agreements.
- 3 A4 4. Establish prudent real estate appraisal and evaluation programs consistent with appraisal regulations (FIRREA Title XI).

ADMINISTRATION

4 Management should monitor conditions in the residential real estate markets in its lending areas so that it can react quickly to changes in market conditions. However, the bank's trade area may not necessitate sophisticated monitoring. If information is readily available, evaluate if management adequately monitors and has a general understanding of the following market conditions:

- 4 A Demographic and economic indicators, including population and employment trends.
 - 4 B Zoning requirements.
 - 4 C Current and projected vacancy, construction, and absorption rates.
 - 4 D Current and projected lease terms, rental rates, and sales prices, including concessions.
 - 4 E Current and projected operating expenses for residential income property.
 - 4 F Valuation trends, including discount and direct capitalization rates.
 - 4 G Speculation through new construction or investments in existing structures.
- 5 Review the bank's accounting for 1-4 family residential mortgage loan fees, points, and costs to determine if the practices are consistent with accounting standards. (Note: The SFAS 91 review may have been completed during the earnings review.)
- 6 Review escrow analysis reports to determine the adequacy of escrow accounting and the status of property tax payments and escrow advances by the bank to cover delinquent property taxes.
- 7 Review the status of mortgage insurance claims to determine collectibility. (Note: Consider the bank's compliance with the procedures imposed by government or private mortgage insurance companies for filing claims.)

DOCUMENTATION

- 8 Review the loan files for the maintenance of appropriate documentation.
- 8 A Determine if the following loan documents are on file:
 - 8 A1 1. Application.
 - 2. Credit Report.
 - 3. Mortgage (or deed of trust).
 - 4. Note.
 - 5. Attorney's opinion or title insurance.
 - 6. Appraisal or collateral evaluation.
 - 7. Evidence of appropriate insurance (property, liability, flood).

8. Commitment letter (the final signed version).
9. Settlement sheet (HUD-1).

9 Determine if real estate loan credit files contain sufficient information regarding additional pledged collateral or credit enhancements.

CREDIT ANALYSIS

10 Review the residential real estate loan portfolio for significant exposure in soft or declining markets and evaluate management's efforts to mitigate increased risks.

11 Determine if loans meet secondary market guidelines. (Note: Coordinate with liquidity analysis.)